

BEFORE THE TENNESSEE STATE BOARD OF EQUALIZATION
ASSESSMENT APPEALS COMMISSION

In re:

TENNESSEE ART LEAGUE, INC.)	
Map 093-05-4, Parcel 045.00)	Davidson County
Claim of Exemption)	

FINAL DECISION AND ORDER

Statement of the case

This is an appeal by the taxpayer from the initial decision and order of the administrative judge who granted partial exemption. The appeal was heard on September 25, 2007 before Commission members Creecy, Gilliam, and Jones.¹ Tennessee Art League (TAL) was represented by attorney Joe Gibbs, and Assistant Metro Attorney Jenny Hayes appeared on behalf of the assessor. State Board of Equalization Staff Attorney Mark Aaron participated on behalf of the Board. Having heard all of the proof on September 25, 2007, the Commission requested that counsel for the parties, as well as Mr. Aaron, submit post-hearing briefs and postponed deliberations for a later date. The deliberations of the Commission members were held on January 24, 2008, via teleconference, in which counsel for the parties, other interested persons, and Board staff participated.

Findings of fact and conclusions of law

The subject property, located at 808 Broadway in Nashville, contains a three story detached brick structure. The first floor, of approximately 2,541 square feet, contains three large art galleries, a gift shop, and supporting areas. The second floor, of approximately 3,119 square feet, contains seven studios and supporting areas. Six of these studios are leased to artists who use the facilities to create their art. The seventh studio is not leased, but is instead used for storage ancillary to the galleries on the floor below. The third floor, of approximately 2,417 square feet, contains two large studios, office space, a library, and supporting facilities. The administrative judge affirmed the initial determination of the designee, denying exemption to the entire property.

Before the Commission, TAL characterized its institutional purposes and its use of the subject property as primarily charitable or educational. We find that the threshold requirement that the property be owned by an exempt institution is met, on the basis that TAL is organized in part to improve public appreciation of the arts. We further find that the occupancy and use of the third floor qualify as charitable or educational within the meaning of the statute, but that the occupancy and use of the first floor and second floor do not qualify as charitable or educational. We therefore modify the order of the administrative judge to provide for exemption of the third floor of the building and land proportionate to the square footage of the third floor divided by the total square footage of the building. However, we uphold the denial of the first and second floor and proportionate land.

¹ Mr. Creecy and Mr. Gilliam sat as designated alternates in the absence of regular members. Mr. Jones sat as a designated alternate for Mr. Stokes, who recused himself due to a conflict.

The threshold question is whether a property is owned by a qualifying exempt institution. Organization as a nonprofit is a necessary but not a sufficient condition for meeting the threshold inquiry. Exemption from federal income tax is not dispositive of state property tax exemption.² The case law, we would note, is not always easily reconciled, but it nonetheless provides us with some fundamental guideposts that we rely on here just as we have in our past decisions.

A nonprofit organization that exists to primarily serve the personal and business interests of its membership does not generally qualify as an exempt institution. For example, in *Lamanna*,³ a labor union was held not to be a charitable institution, in consonance with *Nashville Labor Temple*,⁴ and was held only partially an educational institution. The description of the portions of the building held not to be exempt, including meeting rooms, a lounge, a credit union, and a referral office, suggests that an organization whose actions primarily benefit a membership of persons engaged in a particular trade is not a charitable institution. Nonetheless, the court was willing to consider the union to be a nonprofit educational institution to the extent that it used two classrooms on the property exclusively for electrician training classes. As to educational institutions, the *Lamanna* court examined *Rowan*⁵ as follows:

In [*Rowan*], where exemption was claimed as an educational institution, the educational activities were deemed to be merely incidental and the institution was held to be a social and athletic club. After a review of the activities conducted on the premises, the Court in the *Rowan* case said:

"While defendant club may be said to be an educational institution in a broad sense, we think it cannot be regarded as an educational institution in the sense of section 28 of article 2 of the Constitution. So far the exemption authorized by that section of the Constitution to educational institutions has not been extended to any institutions save schools or institutions where actual instruction was given as from teacher to pupil." 171 Tenn. at 622, 106 S.W.2d at 864.

Lamanna, *supra* at 352-53. In *Memphis Chamber of Commerce*,⁶ a chamber of commerce was held not to be an exempt institution under the following rationale:

It is true it is not a corporation for profit, but, as before stated, its primary object is to promote the business and commercial interests of the city of Memphis... The mere fact that it administers to charity, or may give instructions of an educational nature along certain lines, does not render it an educational or charitable institution in the sense of our Constitution and statute exempting the property of such institutions from taxation.

In the present case, TAL is a dues-based nonprofit membership organization for visual artists. TAL's efforts appear to promote the personal interests of its artist members. However, we believe that, in this case, there is room to find that the applicant is a charitable or educational institution. We so find because the testimony supports that TAL also concentrates a significant amount of its efforts on directly promoting public interest and involvement in art through actual classes and seminars occurring on the

² *Shared Hospital Services Corporation v. Ferguson*, 673 S.W.2d 135 (Tenn. 1984) (granting exemption to nonprofit shared hospital laundry service corporation despite lack of federal income tax exemption recognition); *American Heritage Apartments, Inc. v. Bennett*, 2005 WL 1996623 (Tenn. Ct. App.) (denying exemption to nonprofit corporation notwithstanding its I.R.C. § 501(c)(3) federal income tax exemption status).

³ *Lamanna v. Electrical Workers Local Union No. 474*, 518 S.W.2d 348 (Tenn. 1974).

⁴ *Nashville Labor Temple v. City of Nashville*, 243 S.W. 78 (Tenn. 1921) (declining to hold that the corporation was a charitable institution, even though the participating local labor unions benefited indigent labor union members and their families).

⁵ *State v. Rowan*, 106 S.W.2d 861 (Tenn. 1937).

⁶ *Memphis Chamber of Commerce v. City of Memphis*, 232 S.W. 73 (Tenn. 1921).

third floor of the building and through actual off-site art programs for children and persons with special needs. TAL appears to have enough outwardly-directed community benefit purposes consistent with the traditional notions of education and charity recognized by the Tennessee courts for it to pass the threshold institutional ownership test. It is on this basis that we will proceed to examine the occupancy and use of each floor of the building.

The first floor contains a gift shop and art gallery space. The members can have their knick-knacks and small artwork creations sold on consignment in the organization's gift shop on the first floor. The members also have opportunities to have their artwork displayed for sale in the galleries on the first floor. The applicant generally operates the first floor as a retail space. The applicant retains 25% of the sales price, and the artist receives 75% of the sales price of each knick-knack or artwork. The applicant also holds periodic art exhibit events for members as well as the general public on the first floor. Some of the art exhibited at the events is by more well-known regional artists who may or may not be members of the organization, and not all of the regional artist works displayed may be readily available for sale.

We do not believe that the operation of a commercial art gallery and art gift shop constitutes educational or charitable occupancy and use of property. At some level, commercial activity undertaken incidental to exempt activity becomes taxable, as in the case of the hospital-run fitness center in *Middle Tennessee Med. Ctr.*⁷ That a portion of the revenue not going to the member whose work has been sold goes in part toward the organization's actual charitable or educational work makes no difference.⁸

Members of TAL lease the working studio rooms on the second floor for personal and business uses. The general public has more limited access to the second floor, since the studio units are leased to individual artists. A person from the general public might be able to arrange a visit or get a glimpse of one of the members at work in his or her leased space on the second floor. A customer or potential customer of one of the second floor tenants might also visit for business purposes.

As to the leased studio space, TAL argues that the close proximity of the tenants to each other is conducive to collaboration, allowing the tenants to improve their skills and learn from one another. TAL also argues that the general public has the opportunity to interact with the tenants. While it is true that the lease regulations state that the tenants may be encouraged to interact with the public upon notice to the tenant, we find that the use of the leased space has, at best, only a very coincidental and tenuous connection to actual charity or education. The predominant purpose and use of the leased studios is more precisely illustrated by the remaining details of the regulations. The lease regulations allow the tenant to offer his or her own work for sale in the leased space, allocate responsibility for business licenses and collection and payment of sales tax associated with such sales to the tenant, and clarify that the leased space is a

⁷ *Middle Tennessee Med. Ctr. vs. Assessment Appeals Comm'n.*, No. 01A01-9307-CH-00324, 1994 WL 32584 (Tenn. Ct. App. Feb. 4, 1994) *perm. app. denied* May 9, 1994). The hospital gift shop granted exemption in *Middle Tennessee Med. Ctr.* was exempted on the basis of the peace of mind it afforded hospital visitors. This connection to charitable purpose was not, in our view, established by TAL.

⁸ See Tenn. Code Ann. § 67-5-212(a)(3)(B); *City of Nashville v. State Board of Equalization*, 360 S.W.2d 458, 464-65 (Tenn. 1962) and *Book Agents, supra* at 526 (criticizing and reversing *Hinton*, 167 S.W. 115 (Tenn. 1893), and clarifying that exemption of commercial property is only justified by direct, physical use for an exempt purpose and can not be justified on the basis of use of the proceeds).

working studio that is open to retail traffic. Again, we are unconvinced by TAL's arguments that attempt to abstract the occupancy and use of the second floor studios by the artist tenants into a broader charitable or educational art outreach purpose.⁹ The statutes generally permit exemption of leased property only where the lessee is another exempt entity or a proper beneficiary of the charity or educational service, such as low income housing tenants or a lessee of student housing. These circumstances are not presented here.

TAL's reliance on *Baptist Hospital*, *Christian Home for the Aged*, or *Youth Programs* is, in our view, misplaced.¹⁰ *Baptist Hospital* and *Youth Programs*, which granted exemption, appear to be factually distinguishable from the present case, as a nonprofit hospital was the subject of the former court case and a property used as a staging and parking area for an annual charity golf tournament benefiting a pediatric cancer research hospital was the subject of the latter court case. *Christian Home for the Aged*, which denied exemption to an independent living community whose benefits were restricted to healthy and wealthy elderly residents required to make quid pro quo donations or payments, only serves to reinforce that charity must be first and foremost a gift.¹¹

In the prior Tennessee cases, the outcome as to the exemption of areas used in the business operations of nonprofit organizations has been a factor-based analysis in which competition is a relevant but not a dispositive factor. The outcome, at least as to property actually occupied and used by the institution rather than leased, has typically hinged on the nature of the activity and the extent to which the business activity was "purely and exclusively" for an exempt purpose, that is, whether the use of the property actually and directly served an exempt purpose under current Tenn. Code Ann. §§ 67-5-212(a)(1)(A) and (a)(3)(B).

Our disposition of these claims is consistent with Tennessee Code Annotated § 67-5-212(a)(3)(A)(i). Unlike the other cases we have discussed above, in the present case, artists who are actual members of the applicant organization are legally entitled to receive profit from the first and second floor operations that are in competition with other art galleries and shops that pay taxes. Property is not eligible for exemption if:

The owner, or any stockholder, officer, member or employee of such institution shall receive or may be lawfully entitled to receive any pecuniary profit from the operations of that property in competition with like property owned by others that is not exempt, except reasonable compensation for services in effecting one (1) or more of such purposes, or as proper beneficiaries of its strictly religious, charitable, scientific or educational purposes...

Tenn. Code Ann. § 67-5-212(a)(3)(A)(i). We do not believe this prohibition is limited to competitively-generated profit distributed as dividends.

The first and second floors are operated in competition with like property owned by others that is not exempt. The first floor is operated in direct competition with

⁹ See *Memphis Dev. Found. v. State Board of Equalization*, 653 S.W.2d 266, 270 (Tenn. Ct. App. 1983).

¹⁰ *Baptist Hospital v. City of Nashville*, 3 S.W.2d 1059 (Tenn. 1928); *Christian Home for the Aged, Inc., v. Tennessee Assessment Appeals Commission*, 790 S.W.2d 288 (Tenn. Ct. App. 1990); *Youth Programs, Inc., v. Tennessee State Board of Equalization*, 170 S.W.3d 92 (Tenn. Ct. App. 2004).

¹¹ *Christian Home for the Aged* at 292.

taxpaying art galleries and gift shops. The second floor art studios are leased and operated in direct competition with competing taxpaying landlords, as well as lessees and property owners who are taxpaying manufacturers, distributors, and sellers of art.

As to the first floor operations, members of the organization are paid a percentage of the sale price for their art. Profit to the member is equal to 75% of the sale price minus that member's cost. How the sale price is characterized on TAL's books makes no difference here. As to the second floor operations, members of TAL occupy the studio units to create, market, and sell their artwork. Profit to the member is equal to the sale price of the artwork less the member's cost in producing the artwork. Aside from the thousands of dollars per year due under each lease, that the organization receives no revenue when a member privately markets and sells his or her artwork makes no difference here.

Accordingly, we find and conclude that members of the applicant organization receive or are lawfully entitled to receive profit from the operations of the first and second floor, and that the first and second floors are operated in competition with taxpaying manufacturers, distributors, and purveyors of art.

We do not believe that the argument that the artists are merely being compensated reasonably for services performed has any merit as to the first or second floor operations. Neither in form nor in substance are the artists employed or contracted by the organization to create artwork. The artists create artwork on their own initiatives, for personal enjoyment, to gain personal recognition, and to hopefully make a personal profit. The artists display or put their work on consignment within the applicant's galleries and shops to gain recognition and to hopefully make a profit. While this is commendable, the artists in this capacity are a far cry from being employees or contractors hired to carry on the work of a school or a charity.

For all of the reasons stated above, we find and conclude that the first and second floors of the building fail to qualify for exemption.

In contrast, the third floor is where the direct educational or charitable activities of the organization can be seen. Both free and informal activities, as well as formal classes for fees, are offered in the studios on the third floor. Some of the classes are conducted by members of the organization and attended by the general public. It is with these classes that it is appropriate to conclude that the revenue or profit going to a member of the organization, in his or her role as instructor, represents reasonable compensation for services. Here, an actual educational service is being performed for students who enroll in the classes, the fees do not appear to be excessive, and there appears to be at least some allowance for the underprivileged to attend. The artists in this capacity can be likened to employees or contractors hired to carry on the work of a school or a charity.

There are monthly free lectures that are open to the public on the third floor. An art library is available and open to the general public on the third floor. Further, the third floor houses the office space and meeting areas that the organization administers and plans its direct educational and charitable instructional outreach programs that occur off-site. These off-site programs, often actually conducted by members of the organization, are art instruction and appreciation classes and activities geared towards school children, mental patients, and others with special needs.

For these reasons, we find and conclude that the third floor of the building qualifies for exemption.

ORDER

It is therefore ORDERED, that the initial decision and order of the administrative judge is modified to provide for a partial exemption. Thirty percent (30%) of the value of the property, representing the third floor of the building and proportionate land, shall be exempt, effective October 3, 2005; the remaining seventy percent (70%) of the value of the property, representing the first and second floors of the building and proportionate land, shall remain taxable.

This order is subject to:

1. Reconsideration by the Commission, in the Commission's discretion.

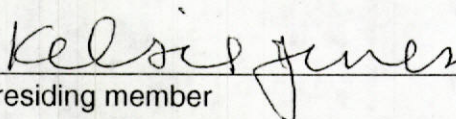
Reconsideration must be requested in writing, stating specific grounds for relief and the request must be filed with the Executive Secretary of the State Board within fifteen (15) days from the date of this order.

2. Review by the State Board of Equalization, in the Board's discretion. This review must be requested in writing, state specific grounds for relief, and be filed with the Executive Secretary of the State Board within fifteen (15) days from the date of this order.

3. Review by the Chancery Court of Davidson County or other county as provided by law. A petition must be filed within sixty (60) days from the date of the official assessment certificate which will be issued when this matter has become final.

Requests for stay of effectiveness will not be accepted.

DATED: Feb. 12, 2008


Presiding member

cc: Mr. Joe Gibbs, Esq.
Ms. JoAnn North, Assessor
Ms. Jenny Hayes, Metro Dept. of Law